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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. 74-829

JUANITA McCLURE, ET AL, *Petitioners*

v.

FIRST NATIONAL BANK AT LUBBOCK, TEXAS, ET AL, *Respondents*

Brief of Respondents in Opposition to Petition for Writ of Certiorari

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v.

FIRST NATIONAL BANK AT LUBBOCK, TEXAS, ET AL, *Respondents*

Brief of Respondents in Opposition to Petition for Writ of Certiorari

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TO THE HONORABLE SUPREME COURT OF THE UNITED STATES:

The First National Bank at Lubbock, Texas, and Sterling Emens, Jr., Respondents herein, submit this Brief in reply and in Opposition to Petitioner's Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, and would respectfully show the following:

OPINIONS OF THE COURTS BELOW

The Opinion of the District Court appears in 352 F.S. 454 (ND Tex., 1973).

The Opinion of the Court of Civil Appeals affirming the judgment of the District Court appears in 497 F.2d 490 (5th Cir., 1974).

JURISDICTION

Petitioner asserts jurisdiction under *28 U.S.C.*, § *1254(1)*.

While this Court has potential jurisdiction of this case, there is no reason for the Court to grant the Petition for Certiorari and exercise jurisdiction. As set forth below, the decisions of the District Court and Circuit Court in this case are clearly correct, and there is no material conflict between these decisions and other decisions pertinent to the issue presented in this case.

STATUTORY PROVISIONS INVOLVED

The statutory provision primarily involved is the Securities Exchange Act of 1934, primarily the provisions of *15 U.S.C.*, § *78j*, providing, inter alia:

> "It shall be unlawful for any person, * * * by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Also involved are the definitions in such Act as contained in *15 U.S.C.*, § *78c*, which are set forth in the Appendix hereto.

QUESTION PRESENTED FOR REVIEW

The statement in the Petition for Writ of Certiorari of "Questions Presented" is, in essence, simply a condensation of Petitioner's arguments and contentions.

There is, in essence, only one question in this case. This is whether Plaintiff's Complaint states a claim or cause of action within the purview of the Securities Exchange Act of 1934, specifically within the provisions of *15 U.S.C.*, § *78j*, quoted above.

The District Court and Circuit Court correctly held that the complaint did not state a claim or cause of action within the purview of the Securities Exchange Act.

Subsidiary questions are the two grounds of the District Court's decision, namely:

(1) Whether the note executed by Gaines County Developments to the First National Bank at Lubbock for $200,000.00 evidencing the loan by the Bank to GCD for such amount (and the deed of trust on land and subsequently pledge of stock securing such loan) constituted a "security" within the purview of the Securities Exchange Act of 1934. Both lower courts held that the note and deed of trust did not constitute a security.

(2) Whether such loan transaction did not constitute the "purchase or sale" of a security within the purview of the Securities Exchange Act of 1934. Again, both lower courts answered in the negative.

A reading of the Petition for Certiorari leaves one with the impression that the various allegations of

fraud and wrongdoing by the Defendants were unequivocally proven facts. Although such allegations are to be considered as being true for the purpose of determining the Motion to Dismiss, it should be kept in mind that such statements are pleaded allegations only, not facts; further, it is not fraud which brings a case within the ambit of the Securities Exchange Act, but fraud in connection with the purchase or sale of a "security."

In order to consider the Petition for Certiorari in proper perspective, it is also important to note two significant matters in the decisions of the District Court and Circuit Court in this case.

First, the courts below clearly did not hold that a note cannot under any circumstances constitute a "security" or that a loan transaction involving a note and/or pledge of stock cannot under any circumstances constitute the "purchase or sale" of a security under the Securities Exchange Act. The courts below simply held that the facts alleged in Plaintiff's Complaint in this case did not constitute allegations of the purchase or sale of a security under the Securities Exchange Act.

Second, the decisions of the courts below do not preclude, or purport to preclude, any suit or recovery by plaintiff against the defendants, either in State or Federal Court, on any cause of action or claim for relief *except* a violation of the Securities Exchange Act. In this regard, the last sentence of the District Court's Memorandum and Order specifically states:

"* * * Accordingly, the Court will enter an

order of even date herewith dismissing the present cause of action for lack of jurisdiction, with prejudice as to said Act *but without prejudice as to any future complaints based upon alternate theories of law upon which this Court passes no judgment.*" (352 F.S., at p. 462) (emphasis ours)

STATEMENT OF THE CASE

Juanita McClure, as Plaintiff, brought this action against her former husband, Adolph R. Hanslik, the First National Bank at Lubbock, et al, as Defendants, alleging jurisdiction under the Securities Exchange Act of 1934, *15 U.S.C.*, §§ *78(a) through 78(u)*. (A 1-8).

Defendant Hanslik was dismissed for the reason that he was previously discharged in bankruptcy (A 74).

This suit was originally filed in the Fort Worth Division of the Northern District of Texas and was subsequently transferred by the Order of that Court to the Lubbock Division of the Northern District (A 75-76).

This appeal by the Plaintiff, Juanita McClure, is from the Memorandum Opinion of the District Court (A 80-90) and Order pursuant thereto (A 96) dismissing the case for failure to state a cause of action within the jurisdiction of the District Court in that the transactions alleged in Plaintiff's Complaint do not constitute the "purchase or sale of any security" within the meaning of the Securities Exchange Act, specifically *15 U.S.C.*, § *78j(b)*. 352 F.S. 454 (ND Tex., 1973).

The allegations of Plaintiff's Complaint are succinctly summarized in the District Court's Memorandum Opinion (A 81-83).

Plaintiff, Juanita McClure, and Defendant, Adolph Hanslik, under the property settlement agreement pursuant to divorce, each retained ownership of one-half of the common stock of Gaines County Development (GCD), a Texas corporation. Defendant Hanslik was president or general manager of the corporation and Plaintiff was secretary.

Plaintiff alleged that on or about August 15, 1964, Defendant Hanslik represented to Plaintiff that GCD needed to borrow $200,000.00 in order to pay GCD business debts, a substantial portion of which were allegedly owed by GCD to Defendant, First National Bank at Lubbock. Plaintiff alleged that a similar representation was made to Plaintiff by Defendant, Sterling Emens, Jr., who was at that time a vice president and loan officer of the Defendant, First National Bank.

Plaintiff alleged that on or about August 15, 1964, she executed a promissory note as secretary of GCD, that Defendant Hanslik also executed such note as president of GCD, and on the same date they also executed a deed of trust for the benefit of the Defendant Bank to secure payment of such note, which deed of trust mortgaged to the Bank a parcel of land in Gaines County which constituted substantially all of the assets of GCD.

Plaintiff further alleged that by reason of fraud and conspiracy between Defendant Hanslik and Defendant Emens, such $200,000.00, or a substantial

part thereof, was not intended by such Defendants to be, nor was it, in fact, applied to the business debts of GCD, but such funds were applied to the payment of a pre-existing unsecured debt owed by Defendant Hanslik to the Bank.

Plaintiff alleged that on or about April 4, 1967, she executed a separate collateral agreement pledging to the Bank a portion of her stock in GCD and in Gaines County Farm and Ranch Corporation for the purpose of securing a new note of $202,316.00, renewing and extending the original note of $200,000.00 made by GCD, and a new deed of trust was executed pursuant to this collateral agreement; that on or about September 3, 1968, after the Bank had instituted foreclosure proceedings, the trustee under the deed of trust sold all the Gaines County property of GCD to the Bank for $125,000.00.

Plaintiff sued for actual and exemplary damages, alleging that the note, deed of trust and other instruments constituted "securities" and the alleged transaction constituted the employment or use of manipulative or deceptive devices in connection with the purchase or sale of securities in violation of § 10(b) of the Securities Exchange Act of 1934 *(15 U.S.C., § 78j (b))* and Rule 10b-5 adopted pursuant thereto.

The District Court dismissed the Complaint on the ground that the notes and collateral instruments under the facts and circumstances alleged by Plaintiff in this case are not "securities" within the meaning of the Securities Exchange Act and on the further ground that the transactions complained of do not con-

stitute the "purchase or sale" of "securities" under the Act.

The District Court specifically provided in its Memorandum Opinion and in the formal Order entered pursuant thereto that such dismissal was without prejudice to any future complaints based upon alternate theories of law upon which the Court passes no judgment (A 94-95, 96).

The action of the District Court in dismissing the Complaint was affirmed by the Fifth Circuit. 497 F.2d 490 (5th Cir., 1974).

SUMMARY OF ARGUMENT

The decision of the District Court, affirmed by the Circuit Court, dismissing Plaintiff's Complaint for lack of jurisdiction in failing to state a claim or cause of action under the Securities Exchange Act was clearly correct.

Under the decisions of this Court and various Circuit Courts, it is clear that the courts are not required to give a mechanical, literal application to congressional statutes; rather the courts have the duty to construe statutes in such a manner as to give effect to the congressional purpose and intent in enacting the statute.

The clear purpose of the Securities Exchange Act as determined not only from the Congressional Record but from various court decisions was to protect *investors, not borrowers.*

While it is true that a note, either singly or in conjunction with other instruments, may evidence an investment transaction within the contemplation and coverage of the Securities Exchange Act, it is equally clear that a loan of money by a bank at interest (or, as stated from the point of view of the borrower, the borrowing of money at interest) does not constitute a "security" or the "purchase or sale" of a security under the Securities Exchange Act. The fact that one of the officers of the corporation to whom the money was loaned may have been guilty of fraud upon another officer and stockholder of the corporation does not convert a loan transaction into a purchase and sale of securities under the Federal Securities & Exchange Act.

In cases construing and involving the Securities Exchange Act, as in cases on any subject matter, it may be possible to find inconsistent (or, at least, arguably inconsistent) results. However, there is certainly no inconsistency in the decisions of the courts below with other decisions involving the Securities Exchange Act, and the decisions of the courts below are clearly consistent with and supported by the authorities cited.

ARGUMENT

(1) Statutes are to be construed in accordance with congressional intent and purpose.

It is fundamental that statutes, and the meaning of the terms and provisions thereof, are to be determined and construed in light of the intention and purpose of the Congress in enacting the statute and in light of the problem at which the statute was directed. *United States v. C.I.O.*, 335 U.S. 106, 92 L.Ed. 1849 (3) (1947); *United States v. Shirey*, 359 U.S. 255, 3 L.Ed.2d 789 (6-8) (1959); *Richards v. United States*, 369 U.S. 1, 7 L.Ed.2d 492, 499 (1961); *FTC v. Meyer*, 390 U.S. 341, 19 L.Ed.2d 1222, 1232-1233 (1967); *Richland Development Company v. Staples*, 295 F.2d 122 (4) (5th Cir., 1961); *Stanga v. McCormick Shipping Corp.*, 268 F.2d 544 (6) (5th Cir., 1959); *Argosy Limited v. Hennigan*, 404 F.2d 14 (6) (5th Cir., 1968); *C.I.R. v. Kelley*, 293 F.2d 904 (3) (5th Cir., 1961; *Wilen Mfg. Co. v. Standard Products Co.*, 409 F.2d 56 (2,3) (5th Cir., 1969); *Miller v. Amusement Enterprises, Inc.*, 394 F.2d 342 (15) (5th Cir., 1968); *Herren v. United States*, 317 F.S. 1198 (5) (SD Tex., 1970), affirmed, 443 F.2d 1363 (5th Cir., 1971).

In *Securities & Exchange Commission v. Joiner Leasing Corp.*, 320 U.S. 344, 88 L.Ed. 88, 93 (1943), this Court stated:

> "* * * However well these rules [of statutory construction] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will con-

> strue the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy."

In *United States v. C.I.O.*, 335 U.S. 106, 92 L.Ed. 1849, this Court said (p. 1856):

> "The purpose of Congress is a dominant factor in determining meaning."

In *United States v. Shirey*, 359 U.S. 255, 3 L.Ed.2d 789, 793, this Court stated:

> "Statutes, including penal enactments, are not inert exercises in literary composition. They are instruments of government, and in construing them 'the general purpose is a more important aid to the meaning than any rule which grammar or formal logic may lay down.' "

In *Argosy Limited v. Hennigan*, 404 F.2d 14, 20 (5th Cir., 1968), the Court pointed out that statutory construction must not occur in a vacuum; that statutes are contextual as well as textual; their proper interpretation requires more than mere linguistic seriation and the courts must look to the logic of Congress and to the broad national policy which prompted the legislation.

In *Miller v. Amusement Enterprises, Inc.*, 394 F.2d 342, 353 (5th Cir., 1968), the Court noted:

> "Our system does not favor mechanical jurisprudence; it seeks to find the purpose and spirit of a statute and the intention of its makers."

And in *Herren v. United States*, 317 F.S. 1198, 1203 (SD Tex., 1970), affirmed, 443 F.2d 1363 (5th Cir., 1971), the Court pointed out that *whether or not the language of the statute is ambiguous*, the Court must look to the legislative history surrounding it.

(2) Clear purpose of the Securities Exchange Act is to protect "investors."

Both the Securities Act of 1933 and the Securities Exchange Act of 1934 are *in pari materia* (relate to the same subject matter) and should be read and construed together as one comprehensive scheme of legislation. *Brown v. Gilligan, Will & Co.*, 287 F.S. 766, 775 (11) (SD N.Y., 1968), and authorities cited.

It is abundantly clear that the purpose of Congress in both the Securities Act of 1933 and the Securities Exchange Act of 1934 was to protect "investors" from the abuses in connection with the sale of stocks and bonds (or substitute instruments serving the same purpose) which had led to the 1929 stock market crash. This is manifest from a reading of the Presidential messages, the Congressional debates and discusion, and the House and Senate Committee reports pertaining to this legislation. Nothing in this legislative history reveals any Congressional intent to create a statutory cause of action applicable to ordinary commercial banking transactions.

In *Securities & Exchange Commission v. Joiner Leasing Corp.*, 320 U.S. 344, 351, 88 L.Ed. 88 (1943), the Court pointed out that securities governed by the Act were defined to cover various documents "* * *

in which there is common trading or speculation and investment."

In *Wilko v. Swan*, 346 U.S. 427, 98 L.Ed. 168 (1953), the Supreme Court said (p. 173):

> "In response to a Presidential message urging that there be added to the ancient rule caveat emptor the further doctrine of 'Let the seller also beware,' Congress passed the Securities Act of 1933. Designed to protect *investors*, the Act requires issuers, underwriters, and dealers to make full and fair disclosure of the character of securities sold in interstate and foreign commerce and to prevent fraud in their sale." (emphasis ours)

In *Securities & Exch. Com'n. v. International Chem. Dev. Corp.*, 469 F.2d 20 (10th Cir., 1972), the Court said (p. 26):

> "* * * The purpose of both provisions is protection of investors from fraudulent practices."

In *Beck v. Securities and Exchange Commission*, 430 F.2d 673 (6th Cir., 1970), the Court said (p. 674):

> "The purpose of the Securities Acts is to protect the *investing public*, SEC v. Ralston Purina Co., 346 U.S. 119, 124, 73 SCT 981, 97 L.Ed. 1494 (1953) * * *." (emphasis ours)

And in *Securities and Exchange Commission v. Briggs*, 234 F.S. 618 (ND Ohio, 1964), the Court said (p. 622):

> "It is true, when courts are called upon to construe statutes, that we are ordinarily concerned

> with the ordinary meaning of words. But we may not take those words out of the context in which they were written, nor may we take the entire legislative act out of the historical context in which it was written. The securities laws were a reaction to the cataclysmic collapse of investments in the period immediately following the great crash of 1929. Since the passage of these acts, courts have consistently stated that they are remedial in nature and must be liberally construed in favor of the *investing public.*" (emphasis ours)

Among numerous cases to the same effect are *Securities and Exchange Commission v. Ralston Purina Co.*, 102 F.S. 964 (4) (ED Mo., 1952), affirmed, 200 F.2d 85 (4) (8th Cir., 1952), affirmed, 346 U.S. 119, 97 L.Ed. 1494 (3) (1952); *Otis & Co. v. Securities and Exchange Commission*, 106 F.2d 579 (6) (6th Cir., 1939); *Campbell v. Degenther*, 97 F.S. 975 (1) (WD Pa., 1951); *Thill Securities Corporation v. New York Stock Exchange*, 433 F.2d 264 (5) (7th Cir., 1970); *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2) (2nd Cir., 1968), certiorari denied, 395 U.S. 906.

It would not be appropriate to attempt to reproduce for submission with this brief all of the pages in the Congressional Records recording the legislative history of these Acts, but all of the Congressional debates and discussions, all of the Senate and House Committee reports and Presidential messages to Congress in connection with these Acts clearly indicate the Congressional purpose to deal with the problem pertaining to investments. There is not a single reference in any of these debates, discussions or Committee reports in any way indicating any intention of Congress in ei-

ther of the 1933 or 1934 Acts to protect "borrowers" to cover or regulate ordinary commercial loan transactions, as involved in the case at bar.

That such was not the Congressional intent is again made manifest by the recent action of the Congress in the passage of the Truth in Lending Act. In *Title 15 U.S.C., § 1603*, which lists exempted transactions, Subdivision 1 exempts credit transactions involving extensions of credit for business or commercial purposes, and Subdivision 2 of this Section refers to transactions in securities.

This again clearly evidences Congressional awareness and recognition of the distinction between ordinary commercial loan and credit transactions and transactions involving securities.

(3) Only fraud in the purchase or sale of securities is within the purview of the Securities Exchange Act.

It is fundamental that the Act only applies to fraud in connection with purchase or sale of securities and that only purchasers or sellers of securities may invoke the protection of the Act. *Simmons v. Wolfson*, 428 F.2d 455 (1,2) (6th Cir., 1970); *Hoover v. Allen*, 241 F.S. 213 (2,3) (SD N.Y., 1965); *Keers & Company v. American Steel & Pump Corporation*, 234 F.S. 201 (1) (SD N.Y., 1964); *Hirsh v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 311 F.S. 1283 (1) (SD N.Y., 1970); *Morrow v. Schapiro*, 334 F.S. 399 (4) (ED Mo., 1971).

In *In Re Penn Central Securities Litigation*, 357 F.S. 869 (8) (ED Pa., 1973), the Court noted that not every corporate act which happens to involve trans-

actions in securities is a "purchase or sale" of securities within the Securities & Exchange Commission Act.

Similarly, in *Supt. of Insurance v. Bankers L. & C. Co.*, 404 U.S. 6, 30 L.Ed.2d 128 (6) (1971), this Court held that the Securities Exchange Act is not intended to regulate transactions which comprise no more than internal corporate mismanagement.

(4) Construction of the term "Security" in 15 U.S.C., § 78j(b).

The term "security" was a term of art in the eyes of Congress when it enacted the Securities Act of 1933 and the Securities Exchange Act of 1934; thus an enumeration of those types of instruments which may constitute a "security" where the context makes such appropiate appears in both Acts. Congress desired to protect "investors," regardless of the myriad instruments available as vehicles in schemes to gull the unwary, and was therefore constrained to make the definition of a "security" as broad as possible, intending, however, to regulate the market for investment capital, not ordinary commerce.

In a number of cases the meaning of "security" as used in the 1933 and 1934 Acts has been before the Supreme Court of the United States, and this Court has consistently defined and delimited the term "security" in line with the clear purpose of the Act to protect investors.

In *Tcherepnin v. Knight*, 389 U.S. 332, 19 L.Ed.2d 564 (1967), this Court, quoting from an earlier deci-

sion in *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293, 299, 90 L.Ed. 1244 (1946), said:

> " * * * As used in both the 1933 and 1934 Acts, security 'embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.' " 19 L.Ed.2d, at page 570.

See, also, *Rekant v. Desser*, 425 F.2d 872, 878 (5th Cir., 1970); *Lawrence v. Securities and Exchange Commission*, 398 F.2d 276 (2) (1st Cir., 1968).

In *Securities & Exch. Com. v. Joiner Leasing Corp.*, 320 U.S. 344, 88 L.Ed. 88, 93 (1943), this Court held that under the Securities Act the term "securities" includes by name or description many documents " * * * *in which there is common trading for speculation or investment.*" (emphasis ours)

In *Roe v. United States*, 287 F.2d 435 (2) (5th Cir., 1961), certiorari denied, 368 U.S. 824, the Court recognized that form is to be disregarded for substance, emphasis is to be placed upon economic realities, and the test of whether a transaction involves a security within the Securities Act is *whether the transaction is or is not a part of a scheme involving an investment of money in a common enterprise with profits to come solely from the efforts of others.* Thus, while Petitioner asserts that the context in which the term "security" is to be defined and construed is that of the Securities Exchange Act itself, the courts have consistently looked to the transaction in question as supplying the

context of construction. *Sanders v. John Nuveen & Co., Inc.*, 463 F.2d 1075 (7th Cir., 1972), certiorari denied, 409 U.S. 1009; *City National Bank of Fort Smith, Arkansas v. Vanderboom*, 290 F.S. 592 (WD Ark., 1968), affirmed, 422 F.2d 221 (8th Cir., 1970), certiorari denied, 399 U.S. 905, 26 L.Ed.2d 560; and *Joseph v. Norman's Health Club, Inc.*, 336 F.S. 307 (ED Mo., 1971).

In *Vincent v. Moench*, 473 F.2d 430 (4) (10th Cir., 1973), the Court said (p. 436):

> "As the trial court saw it, this situation was simply a family partnership, in a state of dissolution as a result of the death of one of the partners. During the period of dissolution, one partner sold her family's interest to the other family partner, and the interest sold was not a security within the meaning of Section 10(b). We agree with the trial court that it would not be compatible with economic realities to say that in these circumstances the interest sold or purchased was a security within the meaning of the Act. We do not think that federal jurisdiction under Section 10(b) can or should be extended to encompass situations of this kind."

In *Investment Company Institute v. Camp*, 274 F.S. 624 (D.C., 1967), reversed on other grounds, 420 F.2d 83 (D.C. Cir., 1969), reversed on other grounds, 401 U.S. 617, 28 L.Ed.2d 367, the Court noted the test set forth by this Court for a security as whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. The Court also held that the meaning of the term "securities" in the Securities Act of 1933 was equivalent in meaning to the term "securities" as used

in the Glass-Steagall Act (governing national banks). The Court referred to the provisions of such Act in *12 U.S.C., §§ 24, 377, 378 and 78.* 274 F.S. at p. 642-643. These provisions of the Glass-Steagall Act, particularly §§ *377 and 378*, provide that no member bank shall be affiliated with any corporation or organization engaged principally in the issue, sale, etc., of stocks, bonds, debentures, notes or other securities, and make it unlawful for any person, firm or organization engaged in the business of issuing or selling stocks, bonds, debentures, notes or other securities to engage at the same time to any extent whatever in the business of receiving deposits subject to check or repayment upon presentation of a passbook. If the word "note" as used in the Securities Exchange Act and the Glass-Steagall Act referred to all notes evidencing obligations in an ordinary loan transaction, national banks would be prohibited from making loans. Thus, here again Congress and the courts have clearly recognized the distinction between the business of issuing securities and ordinary commercial loans made by banks.

It is clear that the Securities Exchange Act was not intended to protect a borrower of money from a bank in an ordinary loan transaction. It is undisputed in the case at bar that the transaction consisted of a loan of money by the First National Bank at Lubbock to GCD with the execution by GCD of a note evidencing such loan and a deed of trust, and subsequently a pledge of stock securing payment of such loan.

It is fundamental that a loan transaction is a delivery of money by one party to the other under a con-

tractual agreement to return or repay such sum, together with an additional sum as interest. *Eisenberg v. Greene*, 346 P.2d 60 (1) (Dist.Ct.App., Cal., 1959); *National Bank of Paulding v. Fidelity & Casualty Co.*, 131 F.S. 121 (1) (SD Ohio, 1954); *State v. Douglas*, 16 NW2d 489 (4) (S.Ct., S.Dak., 1944); *Milana v. Credit Discount Co.*, 163 P.2d 869 (3) (S.Ct., Cal., 1945); *Kline v. Robinson*, 428 P.2d 190 (6) (S.Ct., Nev., 1967); *Liberty Nat. Bank & Trust Co. v. Travelers Indem. Co.*, 295 NYS2d 983, 986 (S.Ct., Erie Co., 1968).

Interest is the amount which one contracts to pay for the use of borrowed money (i.e., compensation for use or forbearance of money). *Equitable Life A. Soc. v. C.I.R.*, 321 U.S. 560, 88 L.Ed. 927 (4) (1943); *C.I.R. v. Morgan*, 272 F.2d 936 (1) (9th Cir., 1959); *Lloyd v. C.I.R.*, 154 F.2d 643 (2) (3rd Cir., 1946); *Wilshire Holding Corp. v. C.I.R.*, 262 F.2d 51 (2) (9th Cir., 1958); *Weller v. C.I.R.*, 270 F.2d 294, 296 (3rd Cir., 1959).

As noted above, the purpose of the Securities Exchange Act was to protect investors which are those placing money for the hope of profit, and also involves trading for speculation. It is clear that an ordinary loan transaction is not within this classification. It is well settled that an agreement to pay a sum based upon a contingency such as profits is not a loan. *Northern Mining Corporation v. Trunz*, 124 F.2d 14 (2) (9th Cir., 1941); *Dinkelspeel v. Lewis*, 62 P.2d 294, 299 (S.Ct., Wyo., 1936); *Rae v. Cameron*, 114 P.2d 1060 (2) (S.Ct., Mont., 1941).

It is clear that a loan does not fit within the intended coverage of the Securities Acts.

(5) Courts below correctly held that loan transaction in this case did not constitute purchase or sale of securities under the Securities Exchange Act.

The decision of the courts below is clearly correct under the decision of this Court in *Tcherepnin v. Knight*, 389 U.S. 332, 19 L.Ed.2d 564 (1967), and the numerous cases cited and discussed in the District Court and Circuit Court opinions. The cases cited and relied upon by Petitioner are distinguishable and are not controlling of the decision in the case at bar.

As held by this Court in *Tcherepnin*, the definition of "security" under the Securities Exchange Act is not rigid but refers to countless and variable schemes devised by those who seek the use of money of others on the promise of profits.

Similarly, as held by this Court in *S.E.C. v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 88 L.Ed. 88 (1943), the term "security" refers to documents in which there is common trading for speculation or investment.

The purpose of the Securites Exchange Act was to protect "investors." *Wilko v. Swan*, 346 U.S. 427, 98 L.Ed. 168 (1953), and other cases cited pages 12-14 above.

Where a note comes within such meaning and is used for such purpose, then the note and transaction come within the purview of the Securities Exchange Act.

Conversely, it is equally clear that every note does not constitute a "security" within the meaning of the Securities Exchange Act and that every loan transaction in which a note is given in evidence of the loan (and collateral instruments providing security for the repayment of such loan) does not constitute the purchase or sale of a security under the Securities Exchange Act. *Rekant v. Desser*, 425 F.2d 872, 878 (5th Cir., 1970); *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville*, 409 F.2d 989, 991-992 (5th Cir., 1969); *Joseph v. Norman's Health Club, Inc.*, 336 F.S. 307 (5) (ED Mo., 1971); *City National Bank of Fort Smith, Arkansas v. Vanderboom*, 290 F.S. 592, 608 (WD Ark., 1968), affirmed, 422 F.2d 221 (8th Cir., 1970), certiorari denied, 399 U.S. 905, 26 L.Ed.2d 560.

Even assuming as true Plaintiff's allegations that Defendant Hanslik was guilty of fraud in obtaining the loan and that Hanslik intended to apply, and did apply, the proceeds of the loan to a personal obligation, it is clear that such facts (of fraud involved in the loan transaction) do not convert the loan transaction into a purchase or sale of securities under the Securities Exchange Act.

An analogous question was before the Ninth Circuit with reference to the California State Securities Act in *Cecil B. DeMille Productions, Inc. v. Woolery*, 61 F.2d 45 (9th Cir., 1932), where the Court said (p. 47):

> "* * * *We* concur with this conclusion, but *desire to emphasize that an ordinary promissory note, whether secured or unsecured, not offered*

> *to the public or sold to an underwriter for the purpose of resale, is not such a security* as to require a permit under the Corporate Securities Act of California." (emphasis ours)

In *Securities and Exchange Commission v. Fifth Avenue Coach Lines, Inc.*, 289 F.S. 3 (26) (SD N.Y., 1968), the Court concluded (p. 38):

> "* * * This is overreaching on an individual loan transaction, but it is not fraud in the purchase or sale of securities within the meaning of the two Acts."

The loan in that case was made by a corporation to an individual stockholder which was used by the stockholder to pay off personal obligations.

In *Beury v. Beury*, 127 F.S. 786 (2) (SD W.Va., 1954), the Court sustained defendant's motion to dismiss, holding that a loan of $70,000.00 made by the defendant, as president of the corporation, to himself, as president of another corporation, was not a purchase or sale of securities within the Securites Exchange Act of 1934 or rules and regulations thereunder, and that the petition stated no cause of action under the Securities Exchange Act.

In *Joseph v. Norman's Health Club, Inc.*, 336 F.S. 307 (5) (ED Mo., 1971), plaintiffs purchased lifetime memberships in the defendant health club and gave promissory notes in payment for such memberships. The Court stated (p. 313):

> "The threshold inquiry in that connection is whether or not the promissory notes executed by

> the plaintiffs are 'securities' within the meaning of the 1934 Act."

The Court discussed the principle stated in *Tcherepnin v. Knight*, 389 U.S. 332, 19 L.Ed.2d 564 (which cited *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293, 90 L.Ed. 1244), that the term "security" embodies a flexible rather than static principle to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profit. The Court concluded:

> "This Court is of the opinion that the context of the present case, like the context of the *Vanderboom* case, requires that the promissory note is other than a security within the meaning of § 10b."

The loans and transactions involved in these above discussed cases much more arguably constitute the purchase or sale of a "security" than in the case at bar.

An analogous question has arisen under the income tax statutes. In *Campbell v. Carter Foundation Production Co.*, 322 F.2d 827 (8) (5th Cir., 1963), the Court had before it the question of whether notes given in that case by the corporate taxpayer to its sole stockholder were to be classified as "stock" or "securities" within income tax statute on tax-free exchanges.

See, also, *Pinellas Ice & C. S. Co. v. Com. of Int. Rev.*, 287 U.S. 462, 77 L.Ed. 428 (1932); *Burnham v. Com. of Int. Rev.*, 86 F.2d 776 (7th Cir., 1936).

In *First Trust & Savings Bank v. Fidelity-Phila-*

delphia Trust Co., 214 F.2d 320 (3rd Cir., 1954), certiorari denied, 348 U.S. 856, there were deposited in defendant's bank by one of its customers notes which were secured by warehouse receipts which were spurious. Subsequently, plaintiff purchased these notes and warehouse receipts and brought this action against the bank to recover its losses when the instruments were discovered to be spurious. The Circuit Court affirmed judgment for defendant, holding that the defendant was not a seller of securities under the Securities Act of 1933. The Court observed (p. 323):

> "If this set of facts constitutes Fidelity a seller under the Securities Act, it seems to us inevitable that every bank which advances money to a customer upon a side draft and negotiable bill of lading is also a seller."

Similarly, in the case at bar, it is clear that if this alleged commercial loan transaction constitutes the purchase or sale of securities under the Securities Exchange Act of 1934, then every commercial loan by every bank would come within the purview of the Securities Act and the Securities Exchange Act of 1934.

Clearly, this is not what Congress intended, and it is not what the Securities Acts provide. Petitioner argues that the distinction between notes issued in commercial transactions and notes issued in investment transactions makes the law uncertain and makes legal advice more tenuous. To this, Respondents say that this dichotomy comports with reality and with the present securities law practice; by stating the distinction clearly, the Courts below have actually finally spelled out

that which the earlier decisions had inferred, to the benefit of the public as well as the bar.

(6) Authorities relied upon by Petitioner.

The cases cited and relied upon by Petitioner are distinguishable and clearly do not compel a contrary holding in the case at bar.

The case of *Rekant v. Desser*, 425 F.2d 872 (5th Cir., 1970), is a prior decision by the Fifth Circuit. In the *Rekant* case, there was not involved a loan transaction, as in the case at bar, and the issuance of the note in that case, rather than shares of stock, was simply a matter of form.

The case of *Sanders v. John Nuveen & Co., Inc.*, 463 F.2d 1075 (7th Cir., 1972), certiorari denied, 409 U.S. 1009, in fact, supports the distinction made by the District Court in the case at bar. In *Sanders*, the Court said (p. 1079):

> "* * * The paper was therefore obviously offered and sold to the general public; indeed, it was characterized in the issuer's financial statements as 'short term open market' paper."

The Court distinguished between a note given in a commercial loan transaction and a note involved in an investment transaction. The Court said (p. 1080):

> "* * * When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment."

Thus, it is clear that *Sanders*, as well as other cases cited by Petitioner, in fact support the distinction which Petitioner criticizes the courts below for making in the case at bar.

Alberto-Culver Company v. Scherk, 484 F.2d 611 (7th Cir., 1973), reversed, 94 S.Ct. 2449, clearly involved an investment transaction in the purchase and sale of a security. This was a transaction in which Alberto-Culver Company was acquiring Scherk's European cosmetic business, specifically the entities referred to as SEV, FLS and Lodeva. Under the agreement, inter alia, SEV was to be converted to a stock corporation, and Alberto was to acquire 100 per cent of the stock of the new corporation. The assets of SEV, FLS and Lodeva entities were to be transferred in exchange for cash and promissory note. There was certainly no ordinary loan transaction involved in the *Scherk* case.

In *Farrell v. United States*, 321 F.2d 409, 417 (9th Cir., 1963), certiorari denied, 375 U.S. 992, there was involved the purchase and sale of securities within the meaning of the Securities Exchange Act, and there was not even any contention to the contrary. This was a criminal case involving a scheme to defraud investors in the sale of securities through the mails. It in no way involved an ordinary commercial loan transaction, as in the case at bar.

The case of *Securities and Exchange Commission v. Coffey*, 493 F.2d 1304 (6th Cir., 1974), reversing in part *S.E.C. v. Crofters, Inc.*, 351 F.S. 236 (SD Ohio, 1972), did not involve a commercial loan transaction

but involved the question of the validity of investment of state funds in corporate notes.

(7) Petitioner's contention concerning collateral pledge of stock.

Petitioner also contends that the collateral pledge of stock to the Bank to secure the loan upon renewal of the note constituted a purchase or sale of securities under the Securities Exchange Act.

This involves the identical question as whether or not the note evidencing the loan was a purchase or sale of securities, and all of the cases cited above are equally applicable to this contention. The purpose of the Act is to protect investors or, stated differently, to cover schemes devised by those who seek money of others on promise of profits, or documents in which there is trading for speculation or investment. *Tcherepnin v. Knight*, 389 U.S. 332, 338, 19 L.Ed.2d 564; *S.E.C. v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 88 L.Ed. 88.

Certainly, just as in the case of a note, a pledge of common stock *may* constitute the purchase or sale of a security. It is equally clear that *every* pledge of stock does not constitute the purchase or sale of a security.

The cases cited by Petitioner are certainly not controlling in the case at bar.

In *S.E.C. v. Dolnick*, 501 F.2d 1279 (7th Cir., 1974), the S.E.C. brought an enforcement action against Dolnick, a securities salesman with a nationally known brokerage firm, to enjoin various violations of the securities law.

The Court found that Dolnick was selling Pig'N Whistle stock between November of 1968 and June, 1970. Such stock was not registered nor exempt from registration. The Court stated that Dolnick pledged as collateral for bank loans thousands of unregistered shares of Pig'N Whistle common stock. The Court stated (p. 1282):

> "* * * Those loans could be repaid only through the unregistered distribution of the pledged shares to the public. He subsequently sold over-the-counter some of those shares as released by the banks to reduce the loan balances with the proceeds of the sales."

Thus, it appears clear in the *Dolnick* case that the pledge of the shares of stock was simply a method of financing the sale of the stock by Dolnick and was simply a process by which Dolnick sold securities (i.e., Pig'N Whistle common stock) for trading and investment.

The other case primarily relied upon by Petitioner, *Fidelity & Casualty Co. of New York v. Key Biscayne Bank*, 501 F.2d 1322 (5th Cir., 1974), is by the Fifth Circuit, the same Court of whose decision Petitioner is complaining in the case at bar.

This case had nothing whatsoever to do with the Securities Exchange Act or the question of purchase or sale of securities under the Act. In this case, 5,000 shares of IBM stock were stolen from the vaults of E. F. Hutton Company. Prior to the discovery of the theft, some of the stolen IBM stock was pledged by a third-party defendant, Charles L. Lewis, to the Key

Biscayne Bank as security for a $195,000.00 loan assertedly for the purpose of acquiring an interest in a Florida airline. When the loan was not repaid, the Bank sold the stock. Fidelity & Casualty Co., as surety of E. F. Hutton Company, brought this action against the Bank to recover the value of the stolen stock certificates. The Court affirmed the decision of the District Court that under Florida law the Bank established prima facie its status as a bona fide purchaser for value without notice of adverse claims.

The Court's decision in *Joseph v. Norman's Health Club, Inc.*, 336 F.S. 307 (ED Mo., 1971), is appropriate to the case at bar. The Court there said (p. 313):

> "* * * The allegations in the instant case are closely analogous to the facts in City National Bank of Fort Smith, Arkansas v. Vanderboom, 290 F.Supp. 592 (S.D.Ark.1968), aff'd 422 F.2d 221 (8th Cir., 1970), cert. denied 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560. In *Vanderboom*, the defendants asserted a counterclaim under Section 10(b) and Rule 10b-5 when they were sued by the Bank on note. The money loaned by the Bank to the defendants was invested in a corporate venture. It appeared that certain officers of the Bank had given some advice with respect to the investment. The District Court gave judgment for the Bank on the counterclaim, stating at p. 608:
>
> "'The short answer to defendants' contention is that the plaintiff bank did not sell or offer to sell any security of any kind to the defendants. The defendants approached the bank and expressed a desire to borrow money which

> they, of their own volition, intended to use in the purchase of capital stock of a corporation . . . organized by themselves. When the proceeds of the notes were delivered to the defendants, the money belonged to them and they could use it in any manner.'
>
> "This Court is of the opinion that the context of the present case, like the context of the Vanderboom case, requires that the promissory note is other than a security within the meaning of § 10b."

Of course, in the *Joseph* case, the money was used by the borrower to purchase stock, and the transaction much more arguably constituted a purchase of securities than did the loan transaction in the case at bar.

CONCLUSION

We respectfully submit that the District Court and the Circuit Court were clearly correct in holding that under the allegations of Plaintiff's Complaint there was not involved in this case a purchase or sale of a security, as a matter of law, that the District Court was clearly correct in dismissing the Complaint for failure to state a cause of action under *15 U.S.C.*, § *78j(b)*, and that the judgments of the courts below should be in all things affirmed.

WHEREFORE, Respondents pray that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Three copies of the above and foregoing Brief of Respondents in Opposition to Petition for Writ of Certiorari have been mailed to Mr. Harold D. Hammett, of Simon & Simon, 800 Baker Building, Fort Worth, Texas 76102, attorneys for Plaintiff-Petitioner, on this ..... day of January, 1975.

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of Counsel

APPENDIX

§ 78c. Definitions and application—Definitions

(a) When used in this chapter, unless the context otherwise requires—

* * * * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security;" or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

* * * * *

(13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.